The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

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The Trade Deficit Stabilizes . . .

The narrowing of the trade deficit in October to $12.06 billion, the smallest monthly figure since August 1985, provides a glimmer of hope that the deterioration of the trade account finally has been arrested. Equally encouraging was the nearly ten percent rise in exports from year-ago levels to $19.33 billion, the highest monthly total since March 1985. This is an important development as prospects for continued growth of the U.S. economy depend to a large extent upon the performance of the trade account. The deepening trade deficit has been a major factor contributing to the disappointing performance of the economy. From a shortfall of $42.6 billion in 1982, the deficit probably will balloon to $165 billion this year. Clearly, such deficits are unsustainable and, if not halted, will further erode our manufacturing base, impede economic activity and, most dangerously of all, may spark greater protectionist sentiment in Congress which could have serious implications for the worldwide economy.

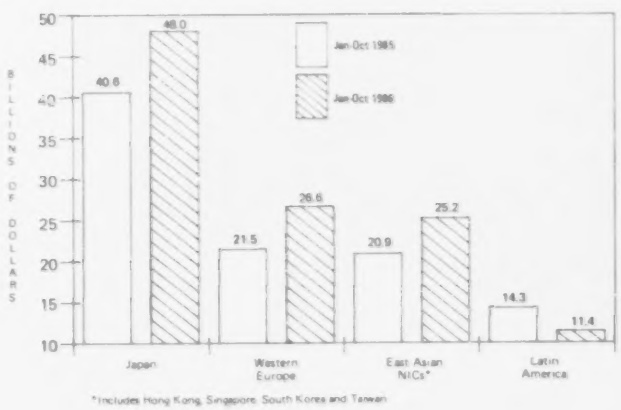
At the beginning of this year, many analysts had anticipated a significant improvement in the U.S. trade position based upon the dollar's substantial decline from its peak of February 1985. Further fueling optimism was the steep fall in oil prices witnessed during the spring. However, the expected turnaround never materialized. Instead, the deficit continued to grow to alarming proportions as imports surged while exports remained weak. This explains the relatively poor performance of the U.S manufacturing sector as well as the disappointing pace of overall economic activity.

There are several factors which play a role in keeping the deficit large. These include sluggish overseas growth, low grain prices which led to a narrowing of the agricultural surplus, the failure of importers to fully adjust their prices to the dollar's decline in order to maintain their market share and the increased importance of East Asia's newly industrialized countries (NICs) as suppliers of manufactured goods. As a result, the trade deficit has grown steadily larger for much of this year, fueling protectionist pressures in Congress.

. . . But Will It Narrow Enough . . .

Recent evidence, however, suggests that the decline of the dollar against some currencies may have arrested the deterioration in the deficit. The shortfall in August, September and October averaged $12.6 billion monthly compared with an average of $14.6 billion monthly during the first seven months of the year. Most of this improvement has been the result of a narrowing in the deficit with the major industrial countries—where the dollar's decline has been most evident. For instance, the shortfall with Germany fell from a peak of $1.72 billion in July to less than $1 billion in October while, with respect to Japan, the deficit contracted from $5½ billion in July to about $5 billion in October.

U.S. TRADE DEFICIT IN SELECTED AREAS
JANUARY-OCTOBER 1986 VS. JANUARY-OCTOBER 1985



*Includes Hong Kong, Singapore, South Korea and Taiwan

This is most encouraging because the major industrial countries account for a big chunk of the global U.S. trade deficit. During the first ten months of 1986, for example, the U.S. had a combined trade deficit of almost $61 billion with Japan and Germany, accounting for 44 percent of the total $139.9 billion shortfall. Therefore, stronger growth in the major industrial nations is one of the necessary preconditions for a sustained improvement in our trade balance. However, the outlook for such growth is not all that bright.

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Earlier this year, hopes for faster growth in Europe were spurred by declining oil prices, falling domestic interest rates and low inflation, which greatly enhanced real purchasing power. But despite such positive developments, growth has remained disappointingly slow and is likely to remain so. Most European nations can expect to expand by only two to three percent in 1987, little changed from the growth rates of this year. As a result, unemployment will remain high, with double-digit rates prevailing in the U.K., France, Italy, Spain and the Netherlands among others. What is more, Japan's economy has been battered by the surge of the yen which has curtailed industrial production, reduced investment outlays and cut exports in both yen and volume terms. Not even the recent reduction in the discount rate to a postwar low of three percent nor the unveiling of a supplementary budget is likely to overcome such negative developments. In fact, the Japanese economy may grow by just two percent this year—its most sluggish performance since the recession of 1974 when the economy was battered by the aftermath of the first oil crisis.

. . . To Boost The U.S. Economy?

However, faster growth in Europe and Japan alone cannot be expected to cure all our trade woes. So deeply entrenched is the deficit that it will take a combination of favorable developments, including faster growth in Europe and Japan, to reduce the shortfall to more manageable proportions. Some of these factors, such as higher grain prices and rapid

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	12/3/86		
U.S. Gov'ts and Agencies Owned Outright & RPs	203.698	+ 1.519	+21.249
Loans to Depository Inst.	.581	− .058	− .992
Float	1.332	+ .704	+ .088
Total Reserve Bank Credit	221.474	+ 2.467	+22.147
Treasury Deposits with Federal Reserve Banks	2.606	+ .132	+ .348
Currency in Circulation	207.163	+ 1.669	+13.426
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	165.896	+ 1.329	+38.722
	12/3/86		
Member Bank Reserves:			
Total Reserves Held	54.750	+ .480	+ 9.052
Excess (Deficiency)	1.330	+ .404	+ .278
Net Free Reserves	1.088	+ .536	+ 2.461

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (11/26/86)	711.6	+ 14.5‡	+ 14.7‡
M2 (October '86)	2,763.9	+ 9.6	+ 8.9
M3 (October '86)	3,443.8	+ 8.2	+ 8.8
Domestic Nonfinancial Debt (2nd Q'86)	7,181.0	+ 11.5	+ 13.1

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 12/5/86	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.40%	5.45%	5.48%
* Federal Agencies	5.60	5.58	5.57
* Municipal Notes—High Grade (46% Taxable Equivalent)	6.94	6.94	7.41
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	5.82	5.82	5.85

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	6.00%	Jan.	6.05%
15- 29 days	5.90	Feb.	5.90
30- 59 days	5.95	Mar.	5.80
60- 89 days	5.90	Apr.	5.75
90-179 days	5.76	May	5.75
180-239 days	5.50	Jun.	5.75
240-270 days	5.50		

‡Industrial Paper—Prime			
30- 89 days	5.98%	†Federal Funds Effective Rate	6.00%
90-120 days	5.88		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'86	$ 4,241	$ 4,176	$ 4,031
Gross National Product (1982 Dollars)*	3rd Q'86	$ 3,687	$ 3,661	$ 3,604
Percent Change, Annual Rate	3rd Q'86	2.9	0.6	4.1
Change in Consumer Prices*	Oct '86n	2.4%	3.6%	4.8%
Change in Producer Prices*	Oct '86	3.6%	4.8%	12.0%
Civilian Employment (Thousands of Persons)†	Nov '86n	110,371	110,240	107,969
Unemployment as % of Civilian Labor Force†	Nov '86n	7.0%	7.0%	7.0%
Personal Income*	Oct '86	$ 3,524	$ 3,512	$ 3,358
Leading Indicators Composite Index (1967=100)†	Oct '86n	180.5	179.5r	171.6
Industrial Production Index (1977=100) †	Oct '86	125.2	125.2	123.6
Net Change in Consumer Installment Credit †	Oct '86n	$ 6.78	$ 7.72r	$ 6.56
U.S. Merchandise Trade Balance	Oct '86n	−$ 12.06	−$ 14.74r	−$ 14.17
Plant and Equipment Expenditures*	4th Q'86	$383.99(a)	$380.52(a)	$397.88
Private Housing Starts (Thousands of Units)*	Oct '86	1,648	1,652	1,784
New Construction Expenditures*	Oct '86n	$ 386.5	$ 380.3r	$ 374.0
Total Business Inventories †	Sep '86	$ 588.4	$ 590.1	$ 579.5
Total Business Sales †	Sep '86	$ 441.6	$ 429.3	$ 427.2

growth in the OPEC nations—which were once lucrative markets for U.S. exporters—are unlikely to develop. Still others, such as a greater export awareness among U.S. companies, will take a long time to develop. Finally, other factors such as the increased importance of the NICs of Asia as suppliers of manufactured goods and the economic weakness of Mexico and other Latin American nations will limit substantial progress on the trade front.

With respect to the NICs of Asia, for example, there has been a structural shift in their favor as a result of their low labor costs and the rise of the yen which has boosted their international competitive position. As a result, the U.S. trade deficit with these nations is likely to expand in the coming years, suggesting that some of the gains on trade with Europe will be offset by a rising imbalance with the Far East. During the first ten months of the year, the U.S. trade deficit with Korea, Hong Kong, Singapore and Taiwan rose by 20 percent from year-ago levels to $25.2 billion (see chart on page 1).

Therefore, although the worst is over, there has yet to be a decisive breakthrough on the trade front. As a result, the trade deficit will remain unacceptably large, suggesting that the dollar may well weaken further against the major world currencies such as the mark and the yen—and will begin to decline against those currencies against which until now it has remained steady.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (11/19/86)	152,531	– 21	5,149
New York City (11/26/86)	34,127	– 88	+ 669
Commercial Paper (11/26/86)	326,480	– 4,603	+36,289

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/19/86)	263,455	+ 776	+ 7,643
New York City (11/26/86)	61,180	– 12	+ 1,944

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/19/86)	758,702	+ 4,350	+ 49,712
New York City (11/26/86)	171,687	+ 3,880	+ 14,629

Financial Markets

	Friday 12/5/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.56%	+ .05	– 1.92
180-Day Bills†	5.64	+ .02	– 2.05
Longest Bills†	5.77	+ .04	– 2.11
Recent Issues:			
6 1/4s 11/31/88	6.20	+ .02	
6 3/4s 9/30/90	6.55	– .01	
7 1/4s 11/15/96	7.08	– .05	
7 1/2s 11/15/16	7.35	– .05	
Municipals:			
Bond Buyer–20 Bond Index* (12/4/86)	6.77%	+ .03	– 1.77
Blue List Total ($ Million)	$2,363	+ $408	+ $ 25
30-Day Visible Supply ($ Million)	$3,987	– $390	– $1,373
Total	$6,350	+ $ 18	– $1,348
Corporates:			
Moody's Aa Composite (12/4/86)	9.02%	+ .49	– 1.90
30-Day Visible Supply ($ Million)	$3,865	– $555	+ $2,285
Stocks:			
Dow-Jones Averages:			
Industrials	1,924.78	+ 64.12	+ 447.60
Transportation	860.87	+ 34.12	+ 167.28
Utilities	211.94	+ 4.72	+ 46.37
65 Stocks	760.28	+ 25.39	+ 168.32
N.Y.S.E. Composite Index	143.69	+ 4.67	+ 26.70
N.Y.S.E. Avg. Daily Vol. for Week (000's)	172,561	+34,833	+ 37,529

* 46% Taxable equivalent 12.54%.

† Bond equivalent.

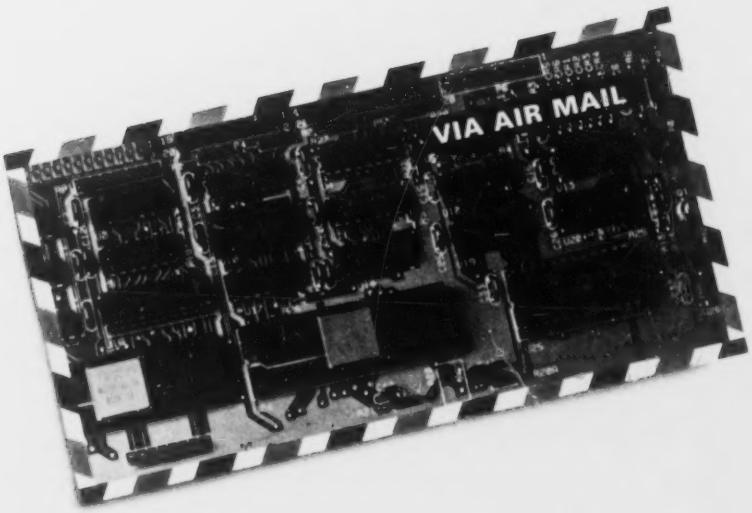
International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 12/5/86	Week Ago
Overnight	5.13%	5.94%
1 month	6.25	6.25
3 month	6.00	6.00
6 month	5.94	5.94
1 year	5.94	6.00
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	7.07%	7.15%
Long Term (7 to 15 yrs.)	7.88	7.94

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/5/86)	U.S. $ Equivalent	Currency Per U.S. $
Canada	.7244	1.3805
France	.1528	6.5425
Germany	.5009	1.9965
Italy	.0007223	1384.50
Japan	.006148	162.65
Mexico	.001145	873.20
Switzerland	.6015	1.6625
U.K.	1.4281	.7002

MH TRADE-WEIGHTED DOLLAR (12/5/86)	Change Since Week Ago	Change Since 2/27/85
	+ 1.0%	+ 2.3%



The Letter of Credit Comes of Age.

For generations, there was not much change in the way importers handled their L/C's. From sending an application to checking on a transaction's status, the process of paperwork and phone calls could take days to complete.

Now Manufacturers Hanover Trust is bringing the L/C into the electronic age with the Electronic Letter of Credit Service. Allowing you to prepare and transmit letter of credit transactions directly to us via Personal Computer. And obtain up-to-the-instant computer reports on your letter of credit activity. Swiftly. Accurately. Securely.

With our Electronic Letter of Credit Service your instructions are acknowledged in seconds, and processed without delay. Opening the way to an early delivery of your shipment—and a savings in time and money.

You can track the status of your L/C's and acceptances through our on-line inquiry capability. A unique feature of which allows you to generate reports in standard formats or to design your own.

Add to all of this the assurance that our dedicated team of trade professionals stands ready to give you prompt answers to all your questions.

So put some byte into your L/C with our Electronic Letter of Credit Service. It's one of a number of products that is opening up a new age in banking.

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